BILL # HB 2380

TITLE: charitable organizations; tax credit

SPONSOR: Anderson

STATUS: As Amended By House WM

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FISCAL ANALYSIS

Description

Beginning in tax year 2008, HB 2380 would eliminate the requirement for a taxpayer to establish a baseline year in order to qualify for the credit for cash contributions to charitable organizations that provide help to the working poor. The bill would also replace the current self-certification requirement of charities with one under which the Department of Revenue (DOR) would determine eligibility based on certain documents furnished by such organizations.

Estimated Impact

Based on currently available data and a set of behavioral assumptions described below, it is estimated that HB 2380 would reduce individual income tax revenues by $(15.0) million in FY 2009, $(16.2) million in FY 2010, and $(17.3) million in FY 2011.

The impact of the bill depends on the behavioral responses of taxpayers to the proposed changes of the credit, which are difficult to predict with certainty. For this reason, the estimates above should be interpreted with caution.

It should be noted that while DOR has not to date provided an estimate for HB 2380, the department estimated the annual cost of an almost identical bill introduced last year (HB 2560) to be between $10 million and $20 million.

Analysis

According to recent data provided by DOR, the credit was claimed by 20,736 taxpayers in tax year 2004 and 23,030 taxpayers in tax year 2005, for a statewide total of $3.8 million and $5.9 million, respectively. The average credit claim was $188 in tax year 2004 and $258 in tax year 2005. The 37% increase of the average claim in tax year 2005 was due to an increase of the maximum credit allowed for married couples. (Pursuant to Laws 2005, Chapter 334, the $200 maximum credit for married couples filing jointly was increased to $300 in tax year 2005 and $400 in tax year 2006 and thereafter.)

According to DOR's most recent "Individual Income Tax Abstract," married couples filing joint returns claimed 80% of the total dollar amounts of all nonrefundable credits available to taxpayers in tax year 2005. However, because the maximum amount for certain tax credits varies by filing status, it would be incorrect to automatically assume that also 80% of all claimants in tax year 2005 were married couples. Thus, in the absence of more detailed tax credit data than currently available, the following assumptions were made for the purpose of this analysis: (1) married couples represent about 70% of all claimants and use on average slightly more than 90% of the maximum allowable credit for donations to charities, and (2) other filers represent the remaining 30% of all claimants and use the same percentage of the maximum credit as married couples.

Based on the existing growth trend for this credit, it is assumed that the number of claimants will increase to 25,300 in tax year 2006, 27,600 in tax year 2007, 29,800 in tax year 2008, 32,200 in tax year 2009, and 34,500 in tax year 2010. Since the average credit claim is assumed to be $325 in each of these tax years, it can be inferred that the cost of the credit under current law would be $9.7 million (= $325 x 29,800) in FY 2009, $10.5 million (= $325 x 32,200) in FY 2010, and $11.2 million (= $325 x 34,500) in FY 2011. These cost estimates represent the expected cost of the credit under current law and are, therefore, referred to as the "baseline estimates" in the remainder of this section.

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This analysis assumes that the baseline estimates above will be affected by 3 behavioral responses to the bill, 2 of which will raise the cost of the credit, and 1 that will lower it. Each of these behavioral responses is discussed below.

HB 2380 Will Make the Credit Available to Taxpayers that Previously Did Not Itemize Their Deductions
Under current law, this credit can only be claimed by those taxpayers that have itemized their deductions for charitable contributions in a prior year. Income tax data provided by the Internal Revenue Service (IRS) indicates that about 60% of Arizona taxpayers claimed the standard deduction in tax year 2004, the last year for which such data is available. Based on this statistic, an estimated 1.4 million Arizona tax filers were automatically precluded from the charitable credit that year.

HB 2380 would make the credit available to all taxpayers, including those that typically only claim the standard deduction for income tax purposes. Based on historical data, 3.0% of those Arizona taxpayers that are expected to itemize their deductions for tax year 2008 will also claim the charitable tax credit. The corresponding figures for tax years 2009 and 2010 are 3.1% and 3.2%, respectively. If the same percentages were applied to taxpayers using the standard deduction, the number of credit claimants would increase by 47,100 in tax year 2008, 50,900 in tax year 2009, and 54,400 in tax year 2010. Since individuals claiming the standard deduction generally earn less than those itemizing their deductions, this analysis assumes that the new claimants will on average use 70% of the maximum allowable credit. The filing distribution of the new credit claimants is assumed to be the same as for those itemizing their deductions. Under these assumptions, the average credit claim would be $242 in tax years 2008, 2009, and 2010. This would result in an additional cost of $11.4 million in FY 2009, $12.3 million in FY 2010, and $13.1 million in FY 2011.

HB 2380 Will Make the Use of the Credit Easier than Previously
Based on information furnished by the Valley of the Sun United Way and other qualifying charitable organizations, it is believed that many taxpayers that were actually eligible for the credit in prior years did not claim it due to the complexity of the credit calculation. Since HB 2380 would simplify the credit calculation considerably (by removing the requirement to establish a baseline year and amount), it is reasonable to assume that a number of previously "discouraged" yet eligible credit claimants would actually use the credit under the new provisions. In other words, the elimination of the baseline year requirement is assumed to induce eligible taxpayers to actually claim the credit.

As noted above, under the baseline estimates, it is expected that 3.0% of taxpayers that itemize their deductions will also claim the charitable tax credit in tax year 2008. This percentage reflects those individuals that would be both eligible for the credit and not deterred by its complexity. Since HB 2380 would eliminate the "deterrence factor" associated with the current credit calculation, this analysis assumes that the bill will result in an increase of the total number of "itemizing" credit claimants by 50%.

The assumption above means that the number of itemizing credit claimants would increase (relative to the baseline estimates) by 14,900 (= 29,800 x 0.50) in tax year 2008, 16,100 (= 32,200 x 0.50) in tax year 2009, and 17,250 (= 34,500 x 0.50) in tax year 2010. It is further assumed that the filing distribution and average claims for these new itemizing credit claimants will be the same as under the baseline estimates above. Thus, the cost associated with the removal of the "deterrence factor" is estimated to be $4.8 million (= $325 x 14,900) in FY 2009, $5.2 million (= $325 x 16,100) in FY 2010, and $5.6 million (= $325 x 17,250) in FY 2011.

New Certification Requirements under HB 2380 Will Disqualify Some Charities from the Credit
This bill would require a qualifying charitable organization to provide written certification to DOR that must include: (1) verification that the organization is exempt from income taxes or is a designated community action agency, (2) financial data indicating the organization's budget for the prior year and the amount spent on services to the working poor, and (3) a statement that the organization will continue to spend at least 50% of its budget on services to the working poor. Under current law, charities are not required to provide such documentation but simply self-certify themselves with DOR.

According to DOR, there are currently slightly less than 700 self-certified charitable organizations in the state. It is expected that a number of these charities will not meet the more stringent certification requirements under HB 2380. To the extent that previous donors to such organizations do not reallocate their contributions to other qualifying charities, the claim of the credit will decrease.

Data from DOR indicates that more than 50% of donations for the purpose of this credit are consistently directed to a group of 12 well-established charities, such as the United Way, Salvation Army, and Habitat for Humanity. Under the baseline estimates, this list of top 12 organizations will on average each receive $404,100 in donations in FY 2009, $436,500 in FY 2010, and $467,000 in FY 2011. By comparison, all other charities are projected to each receive on average $7,000 in

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donations in FY 2009, $7,600 in FY 2010, and $8,100 in FY 2011. For the purpose of this analysis, it is assumed that 25%, or equivalently 175, of the smaller organizations will become ineligible under HB 2380. Under this assumption, the cost of the credit would decrease by $(1.2) million (= $7,000 x 175) in FY 2009, $(1.3) million (= $7,600 x 175) in FY 2010, and $(1.4) million (= $8,100 x 175) in FY 2011.

To conclude, it is estimated that HB 2380 would increase the net cost of the charitable tax credit by $15.0 million in FY 2009, $16.2 million in FY 2010, and $17.3 million in FY 2011. The table below summarizes the estimated General Fund cost (in millions of dollars) for each of the 3 behavioral responses included in this analysis.

Behavioral Responses to HB 2380	FY 2009	FY 2010	FY 2011
Non-Itemizers Will Claim the Credit	$11.4	$12.3	$13.1
Greater Use Due to Less Complexity	4.8	5.2	5.6
Reduced Use Due to More Stringent Certification Requirements	(1.2)	(1.3)	(1.4)
Net General Fund Cost	**$15.0**	**$16.2**	**$17.3**

Local Government Impact

Each year, incorporated cities and towns receive 15% of income tax collections from 2 years prior. This bill would reduce local government distributions by $(2.3) million in FY 2011, $(2.4) million in FY 2012, and $(2.6) million in FY 2013.

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